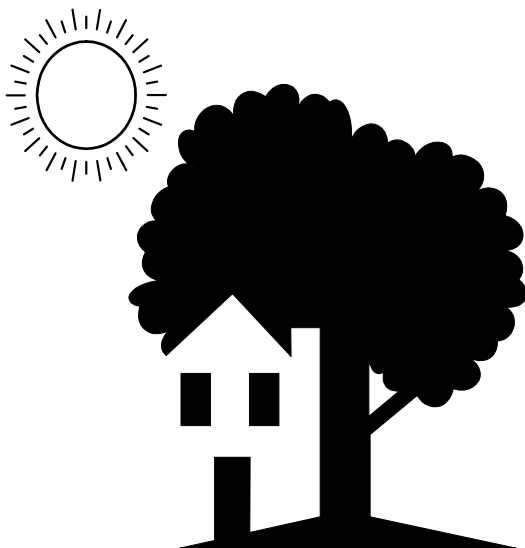




## High-Rate, High-Fee Loans (Section 32 Mortgages)



If you're refinancing your mortgage or applying for a home equity installment loan, you should know about the "Home Ownership and Equity Protection Act of 1994." The law addresses certain deceptive and unfair practices in home equity lending. It amends the Truth in Lending Act (TILA) and establishes requirements for certain loans with high-rates and/or high-fees. The rules for these loans are contained in Section 32 of Regulation Z, which implements the TILA, so the loans also are called "Section 32 Mortgages." Here's what loans are covered, the law's disclosure requirements, prohibited features, and actions you can take against a lender who is violating the law.

### What Loans Are Covered?

A loan is covered by the law if it meets the following tests:

- ♦ the annual percentage rate (APR) exceeds by more than 10 percentage points the rates on Treasury securities of comparable maturity; or
- ♦ the total fees and points payable by the consumer at or before closing exceed the larger of \$451 or 8 percent of the total loan amount. (The \$451 figure is for 2000. This amount is adjusted annually by the Federal Reserve Board, based on changes in the Consumer Price Index.)

The rules primarily affect refinancing and home equity installment loans that also meet the definition of a high-rate or high-fee loan. The rules *do not* cover loans to

purchase or initially construct your home, reverse mortgages, or home equity lines of credit (similar to revolving credit accounts).

### What Disclosures Are Required?

If your loan meets the above tests, you must receive several disclosures at least three business days before the loan is finalized:

- ♦ The lender must give you a written notice stating that the loan need not be completed, even though you've signed the loan application and received the required disclosures. You have three business days to decide whether to sign the loan agreement after you receive the special Section 32 disclosures.
- ♦ The notice must warn you that because the lender will have a mortgage on your home, you could lose the residence and any money put into it, if you fail to make payments.
- ♦ The lender must disclose the APR and the regular payment amount (including any balloon payment where the law permits balloon payments, discussed below) for high-rate, high-fee loans. For variable rate loans, the lender must disclose that the rate and monthly payment may increase and state the amount of the maximum monthly payment.

These disclosures are in addition to the other TILA disclosures that you must receive no later than closing of the loan.

## What Practices Are Prohibited?

The following features are banned from high-rate, high-fee loans:

- ◆ All balloon-payments—where the regular payments do not fully pay off the principal balance and a lump sum payment of more than twice the amount of the regular payments is required—for loans with less than five-year terms. There is an exception for bridge loans of less than one year used by consumers to buy or build a home: in that situation, balloon payments are not prohibited.
- ◆ Negative amortization, which involves smaller monthly payments that do not fully pay off the loan and that cause an increase in your total principal debt.
- ◆ Default interest rates higher than pre-default rates.
- ◆ Rebates of interest upon default calculated by any method less favorable than the actuarial method.
- ◆ A repayment schedule that consolidates more than two periodic payments that are to be paid in advance from the proceeds of the loan.
- ◆ Most prepayment penalties, including refunds of unearned interest calculated by any method less favorable than the actuarial method. The exception is if:
  - ◆ the lender verifies that your total monthly debt (including the mortgage) is 50% or less of your monthly income.

- ◆ you get the money to prepay the loan from a source other than the lender or an affiliate lender; and
- ◆ the lender exercises the penalty clause during the first five years following execution of the mortgage.

Creditors also are prohibited from engaging in a pattern or practice of lending based on the collateral value of your property without regard to your ability to repay the loan. In addition, proceeds for home improvement loans must be disbursed either directly to you, jointly to you and the home improvement contractor, or, in some instances, to the escrow agent.

## How are Compliance Violations Handled?

You may have the right to sue a lender for violations of these new requirements. In a successful suit, you may be able to recover statutory and actual damages, court costs, and attorney's fees. In addition, a violation of the new high-rate, high-fee requirements of the TILA may enable you to rescind (or cancel) the loan for up to three years.

## Where to Go for More Information?

The FTC publishes a series of credit and home-related publications. For a free copy of **Best Sellers**, a complete list of FTC publications, contact: Consumer Response Center, Federal Trade Commission, Washington, DC 20580; toll-free: 1-877-FTC-HELP (382-4357). TDD: 202-326-2502. You also can visit us at [www.ftc.gov](http://www.ftc.gov).